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# State of Utah

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### BULLETIN 2006-5

## Allowable Surrender Charge Schedules For Individual Deferred Annuities

**TO:** Product Development Actuaries of companies issuing annuity contracts in Utah

**FROM:** D. Kent Michie  
Insurance Commissioner

This Bulletin supersedes Bulletin 2002-9. Several sections of Bulletin 2002-9 became outdated as of June 1, 2006. Those sections have been revised in this Bulletin for consistency with the updated code provisions. The unchanged sections of Bulletin 2002-9 are restated in this bulletin.

Utah Code Annotated (U.C.A.) § 31A-22-409, Standard Nonforfeiture Law for Individual Deferred Annuities (*the Law*) specifies minimum nonforfeiture values to be provided by an annuity contract delivered or issued for delivery in Utah. There has been some confusion as to the applicability of *the Law* to some product designs.

#### **Purpose.**

The purpose of this Bulletin is to clarify the provisions of *the Law* related to allowable surrender charge schedules in various product designs of non-registered, general account contracts including traditional fixed annuities, indexed annuities, deposit type annuities, and market value adjusted annuities.

#### **Maturity Date.**

*The Law* defines the maturity date for the purpose of the nonforfeiture calculation. It does not require that a contract terminate or that a contractholder annuitize by that date. For the purpose of the nonforfeiture calculation, the maturity date is the latest date permitted by the contract, but not later than age 70 or the tenth anniversary of the contract, whichever is later. In particular, for annuity contracts issued to persons age 60 or older, the surrender charge period is limited to ten years.

For contracts that provide cash value benefits, *the Law* requires that on and past the maturity date, the cash value available under the contract must be equal to the amount used to determine annuity payments.

**Retrospective Test.**

For contracts issued on or after June 1, 2006, if the contract provides cash value benefits, *the Law* requires that cash values available under the contract be not less than 87.5% of the gross considerations, less withdrawals, loans, rider charges, and partial surrenders, accumulated at a nonforfeiture rate defined in 31A-22-409(5)(b)(i) (based on the five-year Constant Maturity Treasury Rate).

**Smoothness Test.**

For contracts that provide cash value benefits, *the Law* requires that cash values available prior to maturity shall be not less than the amount that would have been available at maturity, arising from the considerations paid prior to surrender, discounted at an interest rate 1% higher than the interest rate specified in the contract for accumulating the net consideration.

**Variable Annuities with Fixed Sub-Accounts.**

Variable annuities, including registered modified guaranteed annuities, are exempt from *the Law*, except that the fixed sub-accounts within variable annuities, which are supported by the general account assets, are subject to *the Law*. The nonforfeiture values associated with the amounts held in the fixed sub-accounts shall be at least as great as those required for a fixed annuity contract.

**Products with Rolling Surrender Charges.**

Flexible premium contracts may have separate surrender charge schedules associated with each premium payment, provided that the nonforfeiture values are at least as great as they would be had each premium payment been a separate single premium contract. The contract shall contain a partial withdrawal provision that allows for withdrawal of monies subject to the smallest surrender penalty first (commonly referred to as first-in first-out). For the purpose of determining the maturity date, the tenth anniversary of the contract may be determined separately for each premium payment.

**Products with Renewing Surrender Charges.**

Contracts that periodically renew interest rate guarantees and surrender charges are in compliance with *the Law* provided that the nonforfeiture values available under the contract following each renewal are at least as great as they would be had the contract been surrendered at renewal and a new contract issued. The contract shall provide for a reasonable time period at renewal, during which the contract can be surrendered free of surrender charges or any other penalties. For the purpose of determining the maturity date, the tenth anniversary of the contract shall be the tenth anniversary of the most recent renewal date.

**Market Value Adjustments.**

Fixed annuities, supported by the general account, that offer periods of fixed rate guarantees may have nonforfeiture values that incorporate market value adjustments (MVAs). To be fair to contractholders that partially bear the investment risk, the MVAs shall equally reflect gains and losses, providing for up as well as down adjustments. MVAs are allowed only during the periods of fixed rate guarantees. Application of the

MVAs cannot result in cash surrender value lower than that resulting from the applicable retrospective test. MVAs can be used in addition to the surrender charge schedule that would have satisfied the smoothness test in the absence of the MVA.

**Bonuses.**

Bonuses that are available only for annuitization are prohibited by *the Law*. Persistency and other bonuses are allowed as long as they are also available in cash at maturity. For the purpose of the nonforfeiture calculation, the bonus shall be treated as an annual rate enhancement over the period during which the bonus is earned. For the purpose of the retrospective test, net considerations need not include the bonus amount. For the purpose of the smoothness test, the bonus amount shall be considered a part of the maturity value, and the interest rate specified in the contract for accumulating the net consideration shall reflect the rate enhancement attributable to the bonus.

**Two-Tier Annuities.**

Subsection U.C.A. 31A-22-409(10)(b) requires that on or past the maturity date, the cash surrender value be equal to the amount used to determine annuity benefits. Therefore, two-tier annuities are not allowed.

**Noncompliant Forms.**

Insurers are advised to review all annuity forms currently filed for use to ascertain that the forms are in compliance with Utah law. If the forms are not in compliance, insurers must cease marketing the forms and file new or revised forms in accordance with the filing rule as posted on the department's website, [www.insurance.utah.gov/industry.html](http://www.insurance.utah.gov/industry.html). Noncompliant forms will be referred to the Market Conduct Division.

**DATED** this 20th day of November 2006

A handwritten signature in cursive script, reading "D. Kent Michie", written over a horizontal line.

D. KENT MICHIE  
Insurance Commissioner